United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING

76-7616

United States Court of Appeals
For the Second Circuit

In Re Franklin National Bank
Securities Litigation

Robert Gold, on behalf of himself and on behalf of all others similarly situated,
Plaintiff-Appellant,

—and—

Louis Pergament,
Intervenor-Plaintiff-Appellant,

—against—

Ernst & Ernst, Harold V. Gleason, Paul Luftig, Peter R. Shaddick, Michele Sindona, Carlo Bordoni, Howard D. Crosse, Andrew N. Garofalo, Donald H. Emrich, and Robert C. Panepinto,
Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

BRIEF OF APPELLEES IN OPPOSITION TO PETITION FOR REHEARING

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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IN RE
FRANKLIN NATIONAL BANK SECURITIES LITIGATION

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No. 76-7616

ROBERT GOLD, et al.,

Plaintiffs-Appellants,

-against-

ERNST & ERNST, et al.,

Defendants-Appellees.

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BRIEF IN OPPOSITION TO PETITION FOR REHEARING

PRELIMINARY STATEMENT

On April 3, 1978, this Court held, among other things, that notice to class members who hold in "street name" is not sufficient compliance with F.R. Civ. P. 23, but that "it is the responsibility of the class representatives to ascertain the names and addresses of these beneficial owners and mail the notices to them, all at the expense of the class representatives," 574 F.2d at 672. During oral argument, plaintiffs' counsel represented to the Court that brokerage houses were insisting upon "huge

and exorbitant fees" for the computer work involved in supplying the names of beneficial owners, although there was nothing in the record on this point. Accordingly, the Court went on to suggest that, in order to eliminate the kind of obstacle with which counsel professed to be concerned, plaintiffs might subpoena the brokers and permit the district court to decide, on a case by case basis, whether the reimbursement they sought was excessive.

In the year that has passed since this Court's decision, plaintiffs have neither paid the brokers to perform the task of identification nor subpoenaed the few who have requested compensation to challenge the reasonableness of the amounts requested. Indeed, as the petition for rehearing makes clear, they expressly refuse to do so. As long as plaintiffs persist in this refusal to comply with the clear directions of this Court, it is impossible as a practical matter to give notice to the persons this Court has held -- we think correctly -- are entitled to notice, and it is therefore impossible to enter any judgment which would not be subject to collateral attack.

Plaintiffs now ask this Court to reconsider its holding that members of the class who held in "street name" are entitled to individual notice, and renew the argument that notice to record holders should be deemed

sufficient for purposes of Rule 23 and due process. This argument was analyzed in considerable detail in the Court's unanimous opinion herein, and categorically rejected, 574 F.2d at 669-71. The reasons plaintiffs now urge for departing from this holding are the alleged burdensomeness of compliance (Pet. 3, 7-9) and the unavailability of subpoenae duces tecum, under plaintiffs' interpretation of Oppenheimer Fund, Inc. v. Sanders, 98 S.Ct. 2380 (1978), as a possible means of shifting some of the costs of identification to brokers (Pet. 9-13).

As discussed below, neither of these arguments furnishes a basis for relieving plaintiffs of their obligation to give individual notice to the members of the class they have chosen to represent, in accordance with this Court's decision herein. On the contrary, if the cost of notice is excessive, the remedy is not a dilution of the notice requirements, but dismissal of the class action, Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974) ("Eisen IV").

ARGUMENT

NEITHER OF THE SUBSEQUENT EVENTS RELIED ON BY PLAINTIFFS WARRANTS DEPARTURE FROM THIS COURT'S HOLDING THAT PLAINTIFFS MUST, AT THEIR OWN EXPENSE, GIVE INDIVIDUAL NOTICE TO MEMBERS OF THE CLASS WHO HOLD IN "STREET NAME".

I. COST OF IDENTIFICATION

Plaintiffs' first argument is at best disingenuous, since the record compiled by plaintiffs themselves now makes clear that the actual cost of identification will be much less than the extravagant sums plaintiffs were predicting at the time of the original decision herein. The record shows that the costs here involved are quite modest. (SA7-8; SA34-84).[1/]

Plaintiffs' own description of the steps taken thus far (SA2-SA10) reveals little that remains to be done except identification of the "street name" purchasers from brokers' records, and the cost of that step is so modest (SA34-SA84) that one broker, which charges $7.50 per hour of computer time, feels constrained to specify a minimum charge of $25.00 (SA70). The broker (now defunct) which quotes the highest price, $747.00, for its (manual) search, has already

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1/ The supplemental appendix, filed with the petition for rehearing ("Pet."), is herein cited "SA__"; the original joint appendix, "A ___."

furnished the names and addresses of its nominees to plaintiffs' counsel (SA55), and at least one other firm states it will not bill the plaintiffs until after the class notice has been mailed to its clients (SA84).

Although plaintiffs make much of the fact that their inquiries to some putative record holders were returned as nondeliverable, and that others have simply failed to respond (Pet. 5-6, 8; SA4-5), this Court's opinion has already given clear direction for dealing with that situation, and the only remaining step to be taken with respect to the non-respondents would appear to be "the direction of notice by publication with respect to a certain number of beneficial owners whose identity cannot be established by reasonable effort," 574 F.2d at 674. Plaintiffs' suggestion that the Court's opinion somehow "requires plaintiffs to initiate subpoena proceedings against non-responding companies" (Pet. 8) finds no support in the Court's opinion and is, we submit, a red herring.

Similarly, plaintiffs' request for relief from the notice requirement where nominees have a policy of confidentiality presents no real issue. Subsequent to the remand, the district court ruled that plaintiffs could satisfy their obligation by obtaining an affidavit

of mailing from the nominee in such circumstances (see transcript of proceedings before Judge Platt on April 28, 1978, p. 12, added to the record on appeal herein by order filed February 3, 1979). The petition for rehearing indicates no intention to appeal that ruling, and we are at a loss to understand why plaintiffs ask this Court to consider that issue anew, without even mentioning the district court's consideration of it.

To the extent that the costs of which plaintiffs are complaining are costs of issuing subpoenas to non-responding brokers outside the New York area, this argument can have no bearing on the reasonableness of requiring identification of beneficial owners, for the subpoena procedure was at most an optional method of reducing plaintiffs' cost, not a requirement of due process, as discussed in Point II, below.[2]

But assuming, *arguendo*, that the costs of identification were prohibitive, the short answer would be that

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2/ The Court's discussion of the subpoena procedure also makes short work of plaintiffs' contention that it would be a "stupendous burden" because of the location of the respondents in different jurisdictions. In fact, after eliminating those within 40 miles of the Eastern District of New York, F.R.C.P. 45(d)(2), the remainder "consist principally of a single brokerage house in cities such as Cleveland, Dallas, San Francisco and New Orleans, with the largest group of 9 in Los Angeles, 6 in Chicago, and 5 in Boston," 574 F.2d at 675. Plaintiffs have apparently inflated those figures by including non-brokers, but this Court was well aware of the true scope of the geographic problem when it reached its decision herein, and apparently did not think it had any bearing on the issue of what constitutes "reasonable efforts".

"there is nothing in Rule 23 to suggest that the notice requirements can be tailored to fit the pocketbooks of particular plaintiffs," Eisen IV, 417 U.S. at 176. Although plaintiffs herein persist in defining "reasonable efforts" as inexpensive ones, this Court has already made clear that, after Eisen, "th[at] question is no longer open," 574 F.2d at 670. Plaintiffs' assumption that the decision herein requiring individual notice to "street name" holders was somehow dependent upon the ease of doing so (Pet. 2-3, 7-8) is refuted by the plain and unambiguous language of the Court's opinion. If these plaintiffs, like those in Eisen, are unwilling to bear the cost of giving notice to the beneficial holders, the solution is not to dispense with the notice, but to dismiss the action.

II. UNAVAILABILITY OF SUBPOENAE DUCES TECUM AS A MEANS OF SHIFTING COSTS

The record on the original appeal contained none of the information now available concerning the actual charges by brokers for use of their facilities to identify the class members. All that was before the Court was the unsupported assertion of plaintiffs' counsel that such costs might exceed $200,000 (A 205). On oral argument, counsel conjured on his own undocumented assumptions the spectre of massive interference by brokers with plaintiffs'

efforts to identify the class.[3/] As Judge Medina described it:

> "On the second oral argument, counsel for the class representatives contended that, shortly after 1966 when the revised Rule 23 took effect, there was no difficulty and no expense involved in obtaining from the brokerage houses the names and addresses of the beneficial owners in cases where 'street names' had been used. Later, he asserts, and after someone saw an opportunity to embarrass or defeat the prosecutions of class actions in cases of alleged security frauds, the brokerage houses ceased this co-operation and insisted upon being paid huge and wholly exorbitant fees for the research and use of computers they said were necessary to cull the names and addresses of the beneficial owners. This is a serious and disturbing situation and we think we can deal with it"

(574 F.2d at 672). The Court's suggestion for dealing with the situation, should it arise, was the use of subpoenae

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3/ What motive brokers might have for such a course of action is not explained and is hard to conceive, since recovery by the class would inure to the benefit of their customers, and indeed to themselves if they held any shares for their own accounts. The conspiracy theory is renewed in the Petition for Rehearing, wherein plaintiffs infer from "the use of similar form letters by several of the brokers" that "certain brokers are seeking to organize a common effort to resist disclosure of the identities of beneficial owners" (Pet. 13, first footnote). On the contrary, industry-wide co-operation on standardization of procedures and charges for identification is much more likely to <u>deter</u> the kind of excessive charges by individual brokers with which plaintiffs profess to be concerned. This is precisely what has occurred with respect to brokers' charges for forwarding issuers' proxy statements, annual reports and the like; the standard industry procedures are now codified in SEC 1934 Act Rule 14a-3(d), 17 C.F.R. §240.14a-3(d), New York Stock Exchange Rules 450-460, American Stock Exchange Rules 575-585, and NASD Rules of Fair Practice Article III, §1 (<u>see</u> NASD Manual (CCH) ¶2151.05, §2)).

duces tecum to permit the district court to determine, on a case-by-case basis, whether the reimbursement requested by brokers was "burdensome," 574 F.2d at 674-76. Nowhere was it suggested that plaintiffs are <u>required</u> to subpoena anyone, or that plaintiffs are to be relieved of the costs of identification in any circumstances other than those in which the reimbursement requested was clearly indefensible, as Judge Gurfein found the broker's claim to be in <u>Blank v. Talley Industries, Inc</u>., 54 F.R.D. 627 (S.D.N.Y. 1972), quoted with approval in 574 F.2d at 675-76.

Plaintiffs now argue that because they interpret <u>Oppenheimer Fund, Inc. v. Sanders</u>, 98 S.Ct. 2380 (1978), as "prohibiting" the use of subpoenas for the purpose of identifying class members, this Court should reconsider its holding that class members must be identified and given individual notice. On the contrary, we submit that the <u>Oppenheimer</u> decision, by holding that it is Rule 23, rather than the discovery rules, which governs identification of class members, reinforces this Court's prior decision herein that plaintiff must identify the members of his class and give them individual notice at his own expense.

If plaintiffs are correct that the <u>Oppenheimer</u> decision "prohibits" the use of subpoenas in the manner

suggested by this Court,[4] it means only that Rule 23 governs allocation of the cost of identification in this case as well, and that subpoenas may not be used to shift some of those costs to non-party brokers. Under Rule 23, as a panel of this Court held at an earlier stage of the Oppenheimer litigation, "the cost of obtaining the name and address to be affixed to the envelope does not differ in kind from the cost of printing the notice and of procuring, stuffing and posting the envelopes," Sanders v. Levy, 558 F.2d 636, 642 (1976) (Palmieri, J.), rev'd en banc, 558 F.2d 646 (1977), rev'd sub nom. Oppenheimer Fund, Inc. v. Sanders, 98 S.Ct. 2380 (1978); accord, In re Nissan Motor Corp. Antitrust Litigation, 552 F.2d 1088 (5th Cir. 1977).

In its prior opinion herein, this Court carved out a limited exception to that rule in the limited -- and thus far entirely hypothetical -- situation where persons not before the court might attempt to impose

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4/ That interpretation is open to question. The issue in Oppenheimer was whether the discovery rules, which plaintiffs had not actually employed, could be used as a rationale for carving out an exception to Eisen IV's rule that the costs of notice may not be imposed on a defendant. The question was not presented whether the notice complied with Rule 23 or due process, since production or non-production of the list by defendants would have meant identification of all of the class members or none of them. The Supreme Court therefore had no occasion to consider whether, if such issues were present, discovery might nevertheless be permissible (1) from non-parties, if there were no other means of identifying class members; or (2) for the limited purposes of challenging the costs for which the non-party sought reimbursement. These questions might have arisen in this case if plaintiffs had in fact subpoenaed any brokers here, and if the brokers had in fact resisted the subpoenae on that ground.

excessive fees for furnishing the necessary information. That potential mechanism for shifting some of the cost of identification may now be unavailable, but plaintiffs' obligation to bear the costs of identification and notice, clearly defined in this Court's opinion, is unaffected.[5]

Plaintiffs' argument that the unavailability of subpoenae to secure judicial review of the reasonableness of the amounts renders the identification requirement unreasonable (Pet. 13) is clearly frivolous in light of the modest amounts required by the brokers who have responded herein. Moreover, even if the costs were exorbitant, they -- and the need for subpoenae to challenge them -- could be avoided altogether by manual inspection of the brokers' underlying hard-copy records. Although most of the brokers herein have expressly offered plaintiffs access to their records at no cost for this purpose (<u>see</u> SA35, 38, 41, 43, 56-57, 60, 63, 69, 77), plaintiffs have made no effort to take advantage of this alternative. Plaintiffs' unwillingness to undertake the effort of manually researching the brokerage

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[5] Whether that obligation should be affected in the event of inappropriate conduct or the imposition of excessive charges by a non-party in possession of necessary information is a question that can be considered when it actually arises; no such fact pattern is present here. It might be noted, however, that even if that situation were to arise, plaintiffs would not be altogether without remedies. For example, with the approval of the district court, any such excessive charges might be deducted from amounts paid in settlement to the particular class members for whom the overcharging broker acted as nominee, <u>cf</u>. <u>In re Penn Central Securities Litigation</u>, 560 F.2d 1138, 1142 (3d Cir. 1977).

records indeed suggests that that would be more expensive to plaintiffs than paying for a computer search -- which in turn points up the reasonableness of the reimbursement requested by the brokers and the artificiality of the issue on which plaintiffs ask this Court to rule.[6] The conclusion is inescapable that plaintiffs' purpose in seeking to reopen this appeal is altogether unrelated to the issues in this case.

CONCLUSION

Plaintiffs should not be permitted to use their own refusal to comply with this Court's decision as a vehicle for reargument of issues already decided. While subsequent events provide no basis for dilution of this Court's decision that "street name" class members are entitled to individual notice, they do reveal how plaintiffs have frustrated the intent of this Court's decision. The Court should deny rehearing and, in so doing, make clear

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6/ Cf. In re Nissan Motor Corp. Antitrust Litigation, 552 F.2d 1088, 1096-99 (5th Cir. 1977), in which the court held that "reasonable efforts" to identify the members of a class of automobile purchasers required plaintiffs, at their expense, to cull the names and addresses from some 1,700,000 dealer registration cards. See also In re Sugar Industry Antitrust Litigation, 73 F.R.D. 322, 359 (E.D. Pa. 1976), where plaintiffs suing on behalf of thousands of retail grocery stores and industrial and institutional users of sugar were required, at their own expense, to obtain the names and addresses of class members from trade associations and other non-parties.

that plaintiffs remain obligated to identify the members of the class at their own expense or, at their option, dismiss the action.

New York, New York
April 24, 1979

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on April 23, 1979 on behalf defendant-appellee Howard D. Crosse I caused a true copy of the within Brief of Appellees in Opposition to Petition for Rehearing to be served by hand upon:

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